Synacor, Inc.
Form 10-Q
August 13, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2013

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number 001-33843

Synacor, Inc.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	16-1542712 (I.R.S. Employer Identification No.)
40 La Riviere Drive, Suite 300 Buffalo, New York (Address of principal executive offices)	14202 (Zip Code)

(716) 853-1362
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	o	Accelerated filer	o
Non-accelerated filer	x (Do not check if a smaller reporting company)	Smaller Reporting Company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

As of July 31, 2013, there were 27,329,886 shares of the registrant’s common stock outstanding. All share and per share amounts in this Quarterly Report on Form 10-Q reflect the 1-for-2 reverse stock split of the registrant’s common stock which took effect immediately prior to the effectiveness of the registration statement for the registrant’s initial public offering.

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PART I — FINANCIAL INFORMATION
Item 1. Financial Statements
SYNACOR, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS—UNAUDITED
AS OF DECEMBER 31, 2012 AND JUNE 30, 2013
(In thousands except for share and per share data)

	December 31, 2012	June 30, 2013
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$41,944	$37,742
Accounts receivable—net of allowance of $25 and $46	15,624	15,346
Deferred income taxes	1,999	945
Prepaid expenses and other current assets	1,831	1,936
Total current assets	61,398	55,969
PROPERTY AND EQUIPMENT—Net	11,043	11,836
DEFERRED INCOME TAXES, NON-CURRENT	2,527	3,779
OTHER LONG-TERM ASSETS	543	560
GOODWILL	819	819
TOTAL ASSETS	$76,330	$72,963
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$14,204	$12,793
Accrued expenses and other current liabilities	7,328	5,866
Current portion of capital lease obligations	2,127	1,905
Total current liabilities	23,659	20,564
LONG-TERM PORTION OF CAPITAL LEASE OBLIGATIONS	1,712	795
OTHER LONG-TERM LIABILITIES	148	177
Total liabilities	25,519	21,536
COMMITMENTS AND CONTINGENCIES (Note 5)		
STOCKHOLDERS' EQUITY:		
Preferred stock, $0.01 par value—10,000,000 shares authorized, no shares issued and outstanding at December 31, 2012 and June 30, 2013	—	—
Common stock, $0.01 par value—100,000,000 shares authorized, 27,517,665 issued and 27,198,165 outstanding at December 31, 2012, and 100,000,000 authorized, 27,641,886 issued and 27,322,386 shares outstanding at June 30, 2013	275	276
Treasury stock—at cost, 319,500 shares at December 31, 2012 and June 30, 2013	(569)	(569)
Additional paid-in capital	99,449	100,764
Accumulated deficit	(48,338)	(48,948)
Accumulated other comprehensive income (loss)	(6)	1
Total Synacor, Inc. stockholders' equity	50,811	51,524
Noncontrolling interests	—	(97)
Total equity	50,811	51,427
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$76,330	$72,963

The accompanying notes are an integral part of these condensed consolidated financial statements.

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SYNACOR, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS—UNAUDITED
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2012 AND 2013
(In thousands except for share and per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2013	2012	2013
REVENUE	$30,807	$26,708	$61,477	$55,851
COSTS AND OPERATING EXPENSES:				
Cost of revenue (exclusive of depreciation shown separately below)	16,876	14,017	33,640	29,781
Research and development (exclusive of depreciation shown separately below)	6,123	7,336	12,411	14,201
Sales and marketing	2,399	2,147	4,776	4,277
General and administrative (exclusive of depreciation shown separately below)	2,868	2,957	5,708	6,101
Depreciation	934	1,138	1,715	2,268
Total costs and operating expenses	29,200	27,595	58,250	56,628
INCOME (LOSS) FROM OPERATIONS	1,607	(887)	3,227	(777)
OTHER EXPENSE	(18)	(8)	(18)	(15)
INTEREST EXPENSE	(89)	(43)	(136)	(101)
INCOME (LOSS) BEFORE INCOME TAXES	1,500	(938)	3,073	(893)
PROVISION (BENEFIT) FOR INCOME TAXES	301	(204)	700	(186)
NET INCOME (LOSS)	1,199	(734)	2,373	(707)
Net loss attributable to noncontrolling interests	—	97	—	97
NET INCOME (LOSS) ATTRIBUTABLE TO SYNACOR, INC.	$1,199	$(637)	$2,373	$(610)
NET INCOME (LOSS) ATTRIBUTABLE TO SYNACOR, INC. PER SHARE:				
Basic	$0.04	$(0.02)	$0.11	$(0.02)
Diluted	$0.04	$(0.02)	$0.08	$(0.02)
WEIGHTED AVERAGE SHARES USED TO COMPUTE NET INCOME (LOSS) PER SHARE:				
Basic	27,212,105	27,311,892	21,907,842	27,273,671
Diluted	29,592,108	27,311,892	28,261,882	27,273,671

The accompanying notes are an integral part of these condensed consolidated financial statements.

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SYNACOR, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)—UNAUDITED
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2012 AND 2013
(In thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2013	2012	2013
Net income (loss)	$1,199	$(734)	$2,373	$(707)
Other comprehensive income:				
Change in foreign currency translation adjustment	9	1	9	7
Comprehensive income (loss)	1,208	(733)	2,382	(700)
Less: comprehensive loss attributable to noncontrolling interests	—	97	—	97
Comprehensive income (loss) attributable to Synacor, Inc.	$1,208	$(636)	$2,382	$(603)

The accompanying notes are an integral part of these condensed consolidated financial statements.

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SYNACOR, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS—UNAUDITED
FOR THE SIX MONTHS ENDED JUNE 30, 2012 AND 2013
(In thousands)

	Six Months Ended June 30,	
	2012	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$2,373	$(707)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation	1,715	2,268
Stock-based compensation expense	983	1,179
Deferred income taxes	616	(198)
Change in assets and liabilities, net of effect of acquisition:		
Accounts receivable, net	(1,171)	278
Prepaid expenses and other current assets	(528)	(105)
Other long-term assets	120	(17)
Accounts payable	782	(1,657)
Accrued expenses and other current liabilities	(155)	(1,269)
Other long-term liabilities	64	29
Net cash provided by (used in) operating activities	4,799	(199)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(2,040)	(2,502)
Cash paid for business acquisition	(600)	(500)
Net cash used in investing activities	(2,640)	(3,002)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment on bank financing	(250)	—
Repayments on capital lease obligations	(1,035)	(1,139)
Proceeds from exercise of common stock options	639	131
Proceeds from initial public offering	25,364	—
Initial public offering costs	(2,753)	—
Net cash provided by (used in) financing activities	21,965	(1,008)
Effect of exchange rate changes on cash and cash equivalents	9	7
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	24,133	(4,202)
CASH AND CASH EQUIVALENTS—Beginning of period	10,925	41,944
CASH AND CASH EQUIVALENTS—End of period	$35,058	$37,742
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for interest	$121	$91
Cash paid for income taxes	83	138
SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING TRANSACTIONS:		
Property and equipment acquired under capital lease obligations	$2,484	$—
Accrued business acquisition consideration	500	—
Accrued property and equipment expenditures	152	822

The accompanying notes are an integral part of these condensed consolidated financial statements.

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SYNACOR, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—UNAUDITED
AS OF DECEMBER 31, 2012 AND JUNE 30, 2013, AND
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2012 AND 2013
(In thousands except for share and per share data)

1. The Company and Summary of Significant Accounting Policies

Synacor, Inc., together with its consolidated subsidiaries (the "Company"), is a leading provider of startpages, TV Everywhere solutions, Identity Management (IDM) and various cloud-based services across multiple devices for cable, satellite, telecom and consumer electronics companies. The Company is also a leading provider of authentication and aggregation solutions for delivery of personalized online content. The Company's technology allows its customers to package a wide array of personalized content and cloud-based services with their high-speed Internet, communications, television and other offerings. The Company's customers offer the Company's services under their own brands on Internet-enabled devices such as PCs, tablets, smartphones and connected TVs.

Initial Public Offering — In February 2012, the Company completed its initial public offering whereby 6,818,170 shares of common stock were sold to the public at a price of $5.00 per share. The Company sold 5,454,545 common shares and selling stockholders sold 1,363,625 common shares. The Company received aggregate proceeds of $25,364 from the initial public offering, net of underwriters' discounts and commissions but before deducting offering expenses of $3,016.

In connection with the initial public offering in February 2012, the Board of Directors of the Company approved a 1-for-2 reverse stock split of the Company's common stock. All common shares, stock options, and per share information presented in these condensed consolidated financial statements reflect the reverse stock split on a retroactive basis for all periods presented. There was no change in the par value of the Company's common stock. The ratio by which shares of preferred stock were convertible into shares of common stock was adjusted to reflect the effects of the reverse stock split. In addition, in accordance with their rights and consistent with the conversion rates discussed in Note 6, Equity, all shares of the Company's outstanding preferred stock were converted into common stock upon the closing of the initial public offering.

Basis of Presentation — The interim unaudited condensed consolidated financial statements and accompanying notes have been prepared in accordance with United States generally accepted accounting principles ("GAAP") and include the accounts of the Company and its wholly-owned or otherwise controlled subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. In the opinion of the Company's management, the interim unaudited condensed consolidated financial statements include all adjustments, which include only normal recurring adjustments, necessary for the fair presentation of the Company's financial position for the periods presented. These interim unaudited condensed consolidated financial statements are not necessarily indicative of the results expected for the full fiscal year or for any subsequent period and should be read in conjunction with the audited consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

Accounting Estimates — The preparation of financial statements in conformity with GAAP in the U.S. requires management to make estimates, judgments and assumptions that affect the amounts reported and disclosed in the financial statements and the accompanying notes. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, actual results may differ from estimated amounts.

Concentrations of Risk — As of December 31, 2012 and June 30, 2013, and for the three and six months ended June 30, 2012 and 2013, the Company had concentrations equal to or exceeding 10% of the Company's accounts receivable and revenue as follows:

	Accounts Receivable	
	December 31, 2012	June 30, 2013

Google	40	%	30	%
Customer A	N/A		16	

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	Revenue							
	Three Months Ended				Six Months Ended			
	June 30,				June 30,			
	2012		2013		2012		2013	
Google	56	%	51	%	59	%	53	%

For the three and six months ended June 30, 2012 and 2013, the following customers received revenue-share payments equal to or exceeding 10% of the Company’s cost of revenue. The costs represent revenue share paid to them for their supply of Internet traffic on the Company's startpages.

	Cost of Revenue							
	Three Months Ended				Six Months Ended			
	June 30,				June 30,			
	2012		2013		2012		2013	
Customer A	20	%	20	%	20	%	20	%
Customer B	17		13		17		14	
Customer C	13		10		13		12	
Customer D	12		11		12		12	

Fair Value Measurements — The provisions of the Financial Accounting Standards Board (“FASB”) Accounting Standard Codification (“ASC”) 820, Fair Value Measurements and Disclosures, establish a framework for measuring the fair value in accounting principles generally accepted in the U.S. and establish a hierarchy that categorizes and prioritizes the sources to be used to estimate fair value as follows:
Level 1 — Level 1 inputs are defined as observable inputs such as quoted prices in active markets.
Level 2 — Level 2 inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (interest rates, yield curves, etc.), and inputs that are derived principally from or corroborated by observable market data by correlation or other means (market corroborated inputs).
Level 3 — Level 3 inputs are unobservable inputs that reflect the Company’s determination of assumptions that market participants would use in pricing the asset or liability. These inputs are developed based on the best information available, including the Company’s own data.
Acquisition — In January 2012, the Company acquired the assets of Carbyn, Inc., or Carbyn, an Ontario, Canada-based company. The assets acquired are principally comprised of mobile device software and technology and other intellectual property, which the Company expects to enhance its efforts in the development of next generation web applications for
mobile devices. The aggregate purchase price was up to $1,100 for the acquired assets, of which $600 was paid upon consummation of the acquisition and the remaining $500 was paid in April 2013. In addition, the Company hired seven employees from Carbyn who have accepted employment with Synacor Canada, Inc., a newly-formed and wholly-owned subsidiary of the Company. The acquisition and its impact on the consolidated financial statements are not material. The purchase price was allocated to the assets acquired based on their respective fair values as of the acquisition date, with the amount exceeding the fair value recorded as goodwill of $819.
Joint Venture—In March 2013, the Company entered into a Joint Venture Agreement, pursuant to which it will initially own 50% of the newly formed Synacor China, Ltd, or the JV Company. In July 2013 the Company provided $400 in initial funding and has agreed to provide up to $1,600 in additional funding to the JV Company over the next two years. Subject to the completion of customary regulatory requirements, the JV Company will, through a wholly foreign-owned subsidiary in the People's Republic of China (the “PRC”), supply authentication and aggregation solutions for the delivery of online content and services to customers in the PRC.
The noncontrolling interests in the condensed consolidated financial statements represent the noncontrolling holders' percentage share of income or losses of the JV Company.

Subsequent Event—In July 2013 the Company made a $1,000 investment (in the form of a convertible promissory note) in a privately held Delaware corporation called Blazer and Flip Flops, Inc., or B&FF (doing business as The Experience

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Engine). B&FF is a professional services company whose principals have experience integrating its customers systems with their consumers' devices, including smartphones and tablets. B&FF has customers in the U.S., Europe and Asia.

2. Property and Equipment—Net

Property and equipment, net consisted of the following (in thousands):

	December 31, 2012	June 30, 2013
Computer equipment (1)	$17,630	$18,167
Computer software	3,715	4,248
Furniture and fixtures	1,050	1,071
Leasehold improvements	732	737
Work in process (2)	226	2,072
Other	173	173
	23,526	26,468
Less accumulated depreciation (3)	(12,483)	(14,632)
Total property and equipment—net	$11,043	$11,836

Notes:

(1) Includes equipment under capital lease obligations of approximately $5,882 and $5,229 as of December 31, 2012 and June 30, 2013, respectively.

(2) Includes internal-use software development costs of $40 and $1,865 as of December 31, 2012 and June 30, 2013, respectively.

(3) Includes $1,834 and $1,990 of accumulated depreciation of equipment under capital leases as of December 31, 2012 and June 30, 2013, respectively.

3. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consisted of the following (in thousands):

	December 31, 2012	June 30, 2013
Accrued compensation	$4,265	$2,515
Accrued content fees	555	953
Accrued property and equipment expenditures	132	439
Accrued business acquisition consideration	500	—
Unearned revenue on contracts	297	554
Other	1,579	1,405
Total	$7,328	$5,866

4. Information About Segment and Geographic Areas

The Company considers operating segments to be components of the Company in which separate financial information is available that is evaluated regularly by the Company's chief operating decision maker in deciding how to allocate resources and in assessing performance. The chief operating decision maker for the Company is the Chief Executive Officer. The Chief Executive Officer reviews financial information presented on a total Company basis, accompanied by information about revenue by major service line for purposes of allocating resources and evaluating financial performance. The Company has one business activity and there are no segment managers who are held accountable for operations, operating results or plans for levels or components below the Company level. Accordingly, the Company has determined that it has a single reporting segment and operating unit structure.

The following table sets forth revenue and long-lived tangible assets by geographic area (in thousands):

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	Three Months Ended June 30, 2012	Three Months Ended June 30, 2013	Six Months Ended June 30, 2012	Six Months Ended June 30, 2013
Revenue				
United States	$30,641	$26,531	$61,155	$55,497
United Kingdom	166	177	322	354
Total revenue	$30,807	$26,708	$61,477	$55,851

	December 31, 2012	June 30, 2013
Long-lived tangible assets		
United States	$10,638	$11,532
Netherlands	405	304
Total long-lived tangible assets	$11,043	$11,836

5. Commitments and Contingencies

Litigation —From time to time, the Company is a party to legal actions. In the opinion of management, the outcome of these matters is not expected to have a material impact on the consolidated financial statements of the Company.

Contract Commitments —The Company is obligated to make payments under various contracts with vendors and other business partners, principally for revenue-share and content arrangements. Contract commitments as of June 30, 2013 are summarized as follows (in thousands):

Year ending December 31:	
2013 (remaining six months)	$2,462
2014	1,419
2015	1,080
2016	1,080
2017	360
Due after 5 years	—
Total contract commitments	$6,401

6. Equity

Common Stock — Effective on February 15, 2012, the Company’s board of directors and stockholders approved the Fifth Amended and Restated Certificate of Incorporation. The total number of common shares that the Company is authorized to issue is 100 million with a par value of $0.01 per share.

Preferred Stock — Effective on February 15, 2012, the Company’s board of directors and stockholders approved the Fifth Amended and Restated Certificate of Incorporation. The total number of preferred shares that the Company is authorized to issue is 10 million with a par value of $0.01 per share. None have been issued to date.

Conversion — Prior to the Company's initial public offering, each share of Series A, A-1, B, and C preferred stock was convertible at the option of the holder at any time into common stock. The conversion rate was the quotient obtained by dividing the original issue price of the Series A, A-1, B, or C by the conversion price. Subsequent to the Second Certificate of Amendment to the Fourth Amended and Restated Certificate of Incorporation, the conversion price was adjusted to effect a conversion of one preferred share into one and one-half common shares, as explained in Note 1, The Company and Summary of Significant Accounting Policies. The conversion price was subject to adjustment as set forth in the Restated Certificate of Incorporation for certain dilutive issuances, splits, and combinations, as therein defined. Conversion was automatic upon either the consent of the holders of 66% of the outstanding shares of preferred stock or the effective date of a firm commitment underwritten public offering of the Company’s common stock in which the post-offering valuation on a fully diluted basis was at least $150 million and the proceeds were not less than $25 million. All shares of the Company’s outstanding preferred stock were converted into common stock in February 2012 in connection with the Company’s initial public offering.

7. Stock-based Compensation

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The Company recorded $425 and $617 of stock-based compensation expense for the three months ended June 30, 2012 and 2013, respectively. Stock-based compensation expense for the six months ended June 30, 2012 and 2013, was $983 and $1,179, respectively. No income tax deduction is allowed for incentive stock options, or ISOs. Accordingly, no deferred income tax asset is recorded for the expense related to these options. Stock option grants of non-qualified stock options, or NQSOs, result in the creation of a deferred tax asset, which is a temporary difference, until the time that the option is exercised.

Total stock-based compensation expense included in the accompanying condensed consolidated statements of operations for the periods presented, is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2013	2012	2013
Research and development	$120	$281	$227	$542
Sales and marketing	99	76	173	152
General and administrative	206	260	583	485
Total stock-based compensation expense	$425	$617	$983	$1,179

Stock Option Activity —A summary of the stock option activity for the six months ended June 30, 2013 is presented below:

	Number of Stock Options	Weighted Average Exercise Price	Aggregate Intrinsic Value (in thousands)	Weighted Average Remaining contractual Term (in years)
Outstanding—January 1, 2013	4,510,807	$4.06		
Granted	1,091,750	3.67		
Exercised	(124,221)	1.07		
Forfeited	(73,702)	8.39		
Outstanding—June 30, 2013	5,404,634	3.95	$ 1,914	7.63
Vested and expected to vest—June 30, 2013	4,943,064	3.87	$ 2,047	7.50
Vested and exercisable—June 30, 2013	2,327,257	2.82	$ 2,800	5.82

Aggregate intrinsic value represents the difference between the Company’s closing stock price of its common stock and the exercise price of outstanding, in-the-money options. The Company’s closing stock price as reported on the NASDAQ as of June 30, 2013 was $3.10. The total intrinsic value of options exercised was approximately $30 and $252 for the three and six months ended June 30, 2013, respectively.

The per-share fair value of each stock option was determined on the date of grant using the Black-Scholes option pricing model using the following assumptions:

Grant Date	Options Granted	Weighted-Average Exercise Price	Expected